

**FIFTH INTERNATIONAL
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ON
ACCOUNTING**

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PAPERS GIVEN IN ENGLISH

The Papers submitted to the Congress were of two kinds—General and National. One General paper was submitted on each of the specified subjects, correlating and commenting upon the several National papers on that subject.

We give in this supplement to ACCOUNTANCY, and in a similar supplement to be issued with the November number, extensive summaries of some of the papers written in English.

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AUDITING BY AND FOR TAX AUTHORITIES*

by

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Since the International Congress is mainly concerned with the subject matter in its reactions on accountants' professional activities, and as the taxes which mostly engage their attention are those annually imposed upon profits and income, the first practical approach must be the study of the duties falling upon practising accountants in the ordinary routine of assessment and collection of these income taxes.

STATUS OF THE PROFESSIONAL ACCOUNTANT.

It is a truism that the profits of a trading entity for any statutory purpose must originate with the books of prime record and proceed thence by stages to the trading and profit and loss accounts and balance sheets, then to the final phase of the adjustments necessary to transform the commercial profit into its statutory counterpart. It is equally clear that the State must take power to intervene in this process at some stage, and it follows that the function of the professional auditor must to some extent vary inversely with the statutory powers conferred upon the officials.

In several countries, for instance Germany, Hungary and Norway, the accounts to be kept by trading enterprises are prescribed by law, and where this is true it is almost a natural sequel that the State should employ officials whose duty it is to see that the statutory regulations are implemented.

In other countries, notably Australia, Holland and the United Kingdom, the statutory requirements as to certain types of books to be kept do not extend beyond limited liability companies, and even so, the regulations are devised mainly for the protection of the shareholders and not for the benefit of the State in relation to taxation. Where the statutory requirements are of this partial character it would usually be inappropriate for the State in its taxing acts to take powers of examination of records which are not in common use, whence it follows that any powers of investigation conferred upon State officials in such circumstances usually partake of a more general character.

Naturally the extent of the functions performed by the State auditors goes far to determine the degree to which reliance is placed upon the independent professional accountant. For example, in the United Kingdom there is no statutory right vested in the State to employ accountants or auditors for the investigation of the books and records of the taxpayer. In practice investigations are altogether exceptional and are confined mainly to cases of evasion and fraud. Virtually the whole of the auditing work leading up to the ascertainment of the taxable profits rests upon the qualified accountant, and probably in no other country in the world is the same degree of responsibility borne by the professional man. It is interesting here to record that in the taxation statutes of the United Kingdom the rights of the accountant in relation to taxation matters are limited to one brief provision empowering him to appear and be heard on behalf of his client before the Appeal Commissioners. This very limited statutory right is in direct contrast with the great part which he actually plays in taxation matters.

GOVERNMENT AUDITS.

The different degrees of State intervention can be illustrated by the cases of Germany, Holland and the Scandinavian countries.

*A General Paper.

In Germany and Holland the State auditors are employed by the Governments and are empowered to examine into and verify the books and records of any taxpayer and to report thereon to the appropriate State department. Thus, effectively, in these countries the State has the power to calculate the liability in the case of any individual taxpayer by reference to the original trading records. It will be realised that in countries where the State possesses and exercises powers of detailed examination into the taxpayer's records, the task of the professional accountant employed by the taxpayer himself becomes particularly onerous by reason of this over-riding right of investigation vested in the fiscal authorities.

In Holland the professional auditor of any taxpayer with the consent of his principal can submit to the State department the taxpayer's accounts and his report thereon. The higher the reputation of the auditor the more likely it is that the State department will accept the accounts and the auditor's report and the taxation returns founded thereon. In special cases, however, the State will exercise its right to have an independent audit performed, and it will be readily realised how serious it would be for the professional auditor should it be found that the report and accounts prepared by him showed material differences from those resulting from the investigation by the State official.

In the Scandinavian countries the method favoured is that professionally known as "the test check" in that the various assessment authorities are empowered in certain cases to employ professional auditors to conduct on behalf of the fiscal department an independent examination of the books and records of the taxpayer. Usually this independent report is made available both to the State department and to the taxpayer, who thereupon has a right of objection. In Norway and Sweden the test check is applied at the discretion of the fiscal authority, but in Denmark the right is limited to cases of difficulty where the liability is in dispute. Once again the onus is on the professional auditor employed by the taxpayer himself to ensure that his duties are discharged with the fidelity which will command a ready acceptance of the accounts by the State department.

The German method is conspicuous for its thoroughness, the programme of the official audit being to conduct an investigation of the accounts of important businesses at least once in every three years. Public companies, however, must submit annual accounts with an audit report thereon to the State department.

INDEPENDENT ACCOUNTANTS EMPLOYED BY GOVERNMENT.

A variant of the permanent State official acting as an auditor of the taxpayer's records is to be found in Sweden, where it is apparently the custom to retain qualified auditors in the service of the provincial taxing authorities for varying periods.

Sweden also has the distinction of employing professional accountants at a stage in the assessing procedure where their expert knowledge can be applied with the greatest effect and advantage both to the State and to the public in securing equity of incidence of the income taxes. It seems that the practice is growing up of employing professional auditors as members of the Committee of Taxes appointed by the appropriate provincial administration, and the method of appointment of the committees is designed to ensure that persons competent to deal with the various branches of trade and industry are adequately represented thereon as well as the legal and accountancy professions.

STATE AUTHORISED AND PROFESSIONAL AUDITORS.

The next in order of attachment to the State department is the professional auditor who acquires his status by being registered as a State-authorized auditor. This system obtains in Denmark, Germany, Norway and Sweden.

By far the largest class, however, is the auditor who is a member of an independent professional body and acquires his qualification by obtaining a diploma from that body.

THE BRITISH TAX SYSTEM.

It is a fact, especially where income tax has been in force for a lengthy period, that it is extremely difficult to reconcile the practice of administration with the statutory foundation on which it rests. This is true to a peculiar extent of the United Kingdom, the country with whose system I am naturally most familiar.

The tradition of the liability of the individual to contribute according to his means to the outlay of the State has always been one of the most potent factors in the fiscal system of Great Britain. It is hardly surprising to find that in the course of nearly a century and a half, experience, coupled with the economic advance of the country, has caused such a development of the practical administration of the tax that to-day it is difficult to reconcile the actual work of assessment and collection with the law on which it rests. In other words, the administration relies largely on custom and practice with but a slight foundation of statutory authority. A relatively slender volume of Acts of Parliament is interpreted in the light of an immensely larger bulk of case law which is constantly and rapidly growing.

Suffice it to say that, although the functions of the State department have expanded enormously in course of time, its statutory powers, save in certain special aspects, remain practically unaltered, the State relying on the accounts and statements rendered by the taxpayer with the assistance of professional auditors, who not only prepare and certify the accounts of the trader, but negotiate on equal terms with the State officials in arriving at a proper calculation of the liability.

REVIEW OF NATIONAL PAPERS—ASSESSMENT AND COLLECTION.

AUSTRALIA.

The laws governing the income tax and sales tax in Australia require the taxpayer to furnish regular returns. The onus of preparation of these returns lies with the taxpayer, who is solely responsible for their accuracy, even when he has engaged an agent to act for him.

Profits for income tax purposes are ascertained from the annual accounts, subject to certain adjustments required by the Acts. The annual audit required by the Companies Acts is useful, although it is normally conducted in the interests of the shareholders or proprietors, with no special reference to taxation. There is no regular examination of taxpayers' books purely for tax purposes.

An audit or investigation by government officials is conducted in special cases when there is suspicion of important irregularities in the taxpayer's returns.

DENMARK.

The Danish national paper epitomises the position in Denmark as follows :—

"The tax basis which has the most connection with the taxpayer's account books is State income and property tax and residence and earnings tax in the parishes.

"The Board of Taxes itself undertakes the control and auditing of the tax basis, so that the work of the auditor in relation to the taxpayers is of an advisory nature. It is, however, very important in the sphere of income and property tax. The work in this sphere is considerable and much appreciated by the Board of Taxes. The work even goes so far that the highest authority for income and property tax matters—the chief Assessor of the country—claims the help of State-authorised auditors in some difficult cases, and the local Boards of Taxes—the Assessors—can, with the approval of the State Board of Taxes, get the help of consultants versed in accounts."

GERMANY.

In Germany the finance authorities regularly inspect accounting books themselves. The post-war years have brought many changes in the German system of taxation. Assessments are based on the annual accounts drawn up according to the provisions of

the commercial law, but with numerous modifications prescribed by the various regulations of the tax law. The modifications have become so extensive that it is now necessary to draw up two separate balance sheets, one in accordance with commercial practice and one for taxation purposes. These differences have led to corresponding differences between the complete audit of the accounts by a professional auditor, which is required by law to be carried out annually, and the audit for tax purposes by an official of the Business Auditing Service of the Reich Finance Administration.

Taxpayers may rely on the advice of their auditors and other professional advisers. "Whereas the official admission by the Revenue Department as 'Helper in Tax Matters' is obtainable relatively easily by members of independent professions and is, for example, granted to professional auditors by law, admission as 'Tax Adviser' is more difficult. Men experienced in tax matters who are in an independent profession can only be admitted with the consent of the Reich Ministry of Finance, whereas for others admission as tax advisers shall be made dependent on attendance at a Reich financial school (there is no examination, but admission depends on expert recommendation).

According to the position in the middle of 1937, the following act as tax auditors and advisers :—

- | | | |
|--|--------|-------------|
| 1. Officials and accountants of the Reich Finance Administration | ... | about 3,000 |
| 2. Professional accountants acting as tax advisers (out of a total of about 1,100) | | 300 |
| 3. Members of independent professions admitted as tax advisers (industrial trustees, lawyers, etc.) | | 2,300 |
| 4. Admitted as helpers in tax matters (excluding the industrial auditors, lawyers, etc., who are admitted by law as above) | | 13,000 " |

HOLLAND.

The value of the services of professional Accountants was recognised in the business world many years before the fiscal authorities availed themselves of auditors to ascertain the amount of profits liable to tax.

"As soon as auditing of the books is desirable, the Inspectors call in the assistance of the State Accountant, their investigations at the tax collector's office remaining of a simple nature.

The government accountant is not subordinate to the Inspector, which in this country is a rather widespread conception, and he stands quite independently *beside* him, officially on an equal footing."

HUNGARY.

In Hungary the board of assessment has been charged to examine commercial books at least every three years. The examination is to be effected by the accounts experts of the Board of Assessment, assisted by economic controllers as advisers.

NORWAY.

The peculiar difficulties to be faced in Norway are clearly indicated by the following quotation from the national paper :—

"Under the statutory definition of income, the gross income is to be composed of the sum which the person liable to tax has earned in money or money's worth in the past tax period (tax year) to December 31st. From this gross income there is first to be deducted, under the tax law, all interest on debts of the taxpayer, and also all expenditure which is clearly a cost of gaining the income.

It is incumbent on every trader to see that he has a systematic and complete set of books, which shall show the capital position, the course of business and the application of the assets, including especially what the business has paid to the proprietor, or to others on his account. The work of the accountant has developed in recent years in the direction that he is often resorted to, in his professional capacity, as tax adviser."

SWEDEN.

In Sweden, tax assessments are based on returns made by taxpayers. Taxpayers often seek professional advice in matters of taxation from lawyers, and also—to an increasing extent—from professional accountants.

Assessments are made in each Province by a Board of Taxes, among whose members there is often a professional accountant. The Audit Committee review assessments on appeal, but may also do so where no appeal has been made. An official audit of the taxpayer's books may be carried out at any time by direction of the Provincial Treasurer. Auditors employed for this purpose are not permanent Government employees, but are engaged under contract from time to time. They are not often Authorised Accountants, probably owing to the restriction on undertaking other work during the currency of a contract.

APPEALS AND THE FUNCTIONS OF THE PROFESSIONAL ACCOUNTANT.

AUSTRALIA.

The taxpayer in Australia has in the first place a right of objection to an assessment made upon him both for the Federal and the State Income Taxes to the appropriate Commissioner of Taxes, the official appointed by and responsible to the Federal or the State Government, who thereupon takes into consideration the objection and any evidence or information which the taxpayer has furnished in support thereof, and may thereafter amend the assessment, serving notice of amendment upon the taxpayer. This does not necessarily conclude the matter since the taxpayer has a further right to require that his appeal shall be heard either by the Board of Review or of Appeal, or, in certain cases, by the Court. The Boards of Review and of Appeal are permanent courts appointed by the Governor-General of the Commonwealth or the Governor of the State.

In some cases the taxpayer can be represented before the Board of Appeal or Review by anyone he may choose to nominate, and frequently this function is performed by practising accountants. In any event both the Government departments and the Board of Review or Appeal look to the accountancy profession for the preparation and submission of the facts and figures which constitute the main data on which their decisions are based.

DENMARK.

Assessments to the Danish income and property taxes are made in the first instance by Councils chosen by the Municipal Government, their assessments being subsequently verified by the tax assessors appointed for each district. Above these district assessors are the chief assessors of the country to whom a right of appeal lies; the latter also form the highest Court of Appeal against assessments to the Residence Tax to which assessments are made in the first place by the Board of Taxes. The authority enjoyed by the Board of Taxes is remarkably wide.

GERMANY.

For a variety of reasons the practice has grown up in Germany of preparing for taxation purposes a separate balance sheet, which may differ in material respects from the balance sheet prepared by an undertaking for the information of its shareholders or for other domestic purposes. The co-existence of two balance sheets is clearly not an ideal position, but as the law stands at present it is apparently inevitable. Indeed, legal decisions and administrative practice have increased the differences. The first step towards reconciling them was taken by the National Socialist tax reform of 1934, which modified the law relating to balance sheets from both aspects. The commercial balance sheet follows the principle of "valuation as low as possible" with ample provision for reserves. The tax law values each item as a part of the undertaking, and reserves which are only "appropriate" or "precautionary" are not tolerated. The report of the auditor employed

by the tax authorities contains both balance sheets. The report is sent to the Assessment Office and a copy is sent to the taxpayer, who has an opportunity of stating any objections before the assessment is made. Appeals against the assessment may be made to the Finance Officer, to the taxation tribunal and finally to the Reich Finance Court. The auditor is informed of the result.

HOLLAND.

The main tax payable by limited companies is the dividend tax, the tax charged on the proportion of the profits earned by companies which is distributed as dividend. This, however, has led inevitably to stringent inquiry by the Revenue authorities into the constitution of limited companies and investigation of the extent to which the profits are ostensibly distributed as dividend. The closest examination is made to ascertain whether the beneficial proprietors derive benefits from the company in ways other than by the distribution of dividend, and power is taken in certain extreme cases for the constitution of the undertaking as a limited company to be ignored.

It will be appreciated that the more important disputes between the State and the taxpayer centre round limited companies and their constitution. As these are primarily legal questions, and particularly having regard to the complication of the fiscal laws, the position has grown up that persons known as tax counsel are habitually entrusted with the representation of the taxpayers in cases of dispute. The first tax counsel were usually persons with legal training who placed knowledge, obtained in the course of their duties, at the disposal of taxpayers.

NORWAY.

In Norway the assessments are made in the first place by the Assessment Committee and the Assessment Council, the taxpayer having a period of four weeks within which to appeal against the assessment. These objections are heard by the Higher Assessment Committee. A further right of appeal against the decision of this committee lies to the Provincial Tax Authority, above which is the National Tax Authority known as the Rikskattestytret, leaving the Royal Courts of Justice as the highest tribunal in tax matters before which legal actions are brought for settlement.

ROUMANIA.

In many countries it has frequently been recommended that the tribunals entrusted with the settlement of disputes between the State and the public relating to taxes on profits and earnings should have the advantage of the services of independent expert advisers and it has always been considered that a practising accountant was the most suitable type of expert. In Roumania this procedure has been in operation for several years and is stated to have achieved a high degree of success.

SWEDEN.

Tax returns in Sweden are made in the first place to the Committee of Taxes, which makes the assessment. Appeals against this assessment lie to the Audits Committee which, however, has the additional power of making adjustments where necessary in the taxpayer's assessment without any appeal having been made. Further appeals against the decision of the Audits Committee may be made to the Court of First Instance, and finally to the highest tribunal, the Government Court of Justice.

UNITED KINGDOM.

It is hardly surprising to find that the writer of the British paper deals at length with the functions which as a matter of habit and practice the qualified accountant performs in relation to the taxation liabilities of his clients. "It is certainly not too much to say

that in the absence of the loyal co-operation of the accountancy profession, supported by its high and accepted ethical standards, the present system of administration would be unequal to the task."

It is only in a negligible proportion of the more important cases which are actually heard by the Appeal Commissioners that the taxpayer is represented by anyone other than his accountant, and it is probably not going too far to say that the certificate of a properly qualified accountant is universally accepted by the Appeal Commissioners as conclusive of the accuracy of the accounts. The decision of the Appeal Commissioners is final on issues of fact, but if a point of law is involved either side can, by giving due notice, require a case to be stated for the opinion of the High Court. This right of appeal is the most valuable right which the taxpayer has, and not the least important of the accountant's functions is the conduct of such appeals, the preparation of the facts and figures to be laid before the Commissioners, and the presentation of these to the tribunal in a clear and convincing manner.

DIFFERENCES BETWEEN PROFITS FOR TAXATION PURPOSES AND FOR COMMERCIAL PURPOSES.

In every country the statutory profits assessable to the various income taxes differ from the profits as determined for commercial purposes. Naturally, the degree of divergence varies materially in the various countries, and it is this degree which decides the practical method of ascertaining statutory profits from the accounts and records of each particular business. In Germany a state of complexity has been reached which requires the preparation of entirely separate accounts for the purposes of income tax, but this is the extreme case, since in most other countries it is found practicable to compute the statutory profit by grafting adjustments on to the results shown by the commercial accounts.

In modern industry one of the most noticeable factors is the development and elaboration of machinery and plant. Expenditure on plant and machinery tends constantly to grow, and it is one of the major preoccupations of all concerned that in the ascertainment of the annual profits adequate provision shall be made for the real burden falling upon the industry in respect of the maintenance of the plant and equipment at its maximum efficiency.

I would suggest, therefore, that the discussion should be directed to this important question in the following aspects:—

The allowances granted by various taxation authorities:—

1. In respect of depreciation, obsolescence and replacement of plant and machinery used for the purposes of trade or business.
2. For the depreciation of factories and other industrial buildings.
3. For the amortisation of wasting assets whether tangible or intangible.

In regard to all these matters the most interesting aspect will be the contrast between the allowances granted for taxation purposes and the provisions which are deemed expedient from the commercial standpoint.

AUDITING OF CONCERNS*

by

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INTRODUCTION.

German accounting practice has made a definite contribution to accounting terminology in the use of the word *Konzern*, which appears to have no exact counterpart in English but which for the purpose of all the papers has been taken to mean "holding company." It is apparent, however, that the term has a wider meaning in Germany, covering, in addition to holding companies as generally understood, groups of undertakings linked together for economic purposes under centralised management. I propose to base my paper in the main on the auditing of "concerns" which are operated as joint stock companies and to utilise the terms holding company and subsidiary company when referring to the head and constituent members of a *Konzern* respectively.

HISTORICAL BACKGROUND AND DEVELOPMENT.

Holding companies are essentially a product of the growth of large-scale business and concentration of capital which has taken place since the commencement of the twentieth century, and which received a great impetus in the years following the war of 1914-1918.

The main objects of forming holding companies appear to have been the same in all countries from which papers have been submitted, namely, the elimination of competition by the amalgamation of numbers of businesses engaged in similar industries or the bringing within one control of the various stages in the production and distribution of particular groups of articles or services.

LEGAL PROVISIONS IN REGARD TO ACCOUNTS

In none of the countries to which the national papers relate does the law distinguish between holding companies and other public companies in the keeping of the accounts, and whilst most legal systems call for disclosure of specific items in the published accounts of public companies, whether holding or otherwise, in no instance is a precise form laid down. Thus, great reliance is placed on the judgment and discretion of the directors and auditors as to the most appropriate basis in each particular case.

It is only in the various legal provisions dealing with disclosure in published accounts that one finds definitions of what are to be regarded as holding and subsidiary companies, respectively. Thus, in the U.S.A. Securities Act of 1933, and the Securities Exchange Act of 1934, the term "parent," *i.e.*, holding company, refers to a company which controls another, *i.e.*, a subsidiary company, directly or indirectly by the ownership of securities representing more than 50 per cent. of the voting power. In England the corresponding provision is to be found in the Companies Act, 1929, where a subsidiary company is defined as one in which the holding company owns one or more shares and further holds either more than 50 per cent. of the issued capital of the subsidiary or such a proportion thereof as gives voting control, or has power to appoint the majority of the directors. It is important to note, however, that direct ownership is necessary under English law in order to constitute one company a subsidiary of another: consequently, if A owns all the share capital of B, which in turn owns all the share capital of C, under English law B is a subsidiary of A and C is a subsidiary of B, but C is not a subsidiary of A, whereas it would be so under American law. In Germany the decisive factor is control of management, although in cases of doubt the holding of 25 per cent. of the capital is held to constitute "participation."

In Sweden legal provision is made for the disclosure of investments in other companies, but there are no legal directions as to the definition or specific disclosure of investments

*A General Paper.

in subsidiary companies. The legal position in France and Hungary appears to be somewhat similar to that in Sweden.

In England a consolidated statement has no standing in law and the undermentioned particulars have to be shown under separate headings in the balance sheet of the holding company:—

- (a) The aggregate book value of the shareholdings in subsidiary companies.
- (b) The aggregate of the amounts owing by subsidiary companies to the holding company.
- (c) The aggregate of the amounts owing by the holding company to subsidiary companies.

It is also necessary for the directors to annex to the accounts of a holding company a statement showing the basis on which the aggregate profits and losses of subsidiary companies have been dealt with in the accounts of the holding company and the subsidiary companies, together with particulars of any "qualifications" in the reports of the auditors of the subsidiary companies.

Practice has disclosed certain inherent weaknesses in these provisions. Thus, they apply only to direct subsidiaries and not to sub-subsidiaries; further, as only the basis of dealing with profits and losses of subsidiaries has to be stated and not the amounts thereof, the statement does not necessarily convey more than a general indication of the trading results of the subsidiary companies. I suggest an appropriate subject for debate is as to what extent the profits and losses of subsidiaries ought to be disclosed.

PRACTICE IN REGARD TO PUBLICATION OF ACCOUNTS.

There is no uniformity in the method of presentation of annual accounts of holding companies. Consolidated financial statements were in fairly general use in the United States of America before there was any statutory recognition of them. There is still no legislation requiring their use for other than registration purposes—even this being optional—but the need for a more comprehensive statement of the financial structure of present-day business-organisms has resulted in the general adoption of this type of annual account. In practice varying forms are adopted, and there is considerable divergence of opinion as to many detailed points arising on their preparation and construction, but with each form the ultimate object is the same, namely, to give a general picture of the combined financial condition of the holding company and its subsidiaries.

In England, consolidated statements are issued by comparatively few holding companies, although the number tends to increase. The legal requirements for disclosure in the balance sheet are, in practice, not exceeded and most holding companies do not state separately in the profit and loss account the amount of profits or dividends brought in from subsidiary companies, nor is any disclosure made of the amount of any losses which have been provided for. Certain companies issue a complete consolidated statement in the form of a balance sheet and revenue account with their annual accounts; in some instances these are separately certified by the auditors as showing a true view of the state of the company's affairs. The absence of instructions as to the form or contents of the directors' annual report has resulted in practice in these being very brief and formal, and it is unusual for much information to be contained therein.

SUGGESTIONS AS TO THE FORM OF PUBLISHED ACCOUNTS.

(a) *Balance Sheets.*

It appears to be universally agreed that the normal or legal form of balance sheet does not convey sufficient information to the shareholders of a holding company, and that some form of consolidated financial statement should also be issued.

In the matter of consolidated statements English practice appears to be somewhat behind that of other countries, but I notice that even in the United States, where consolidated statements are probably more common than elsewhere, they are stated to be supplemental to the normal accounts. I think it is agreed by all that investments in and amounts due by or to subsidiary companies should continue to be segregated from other items in balance sheets, and the various papers recommend showing accrued profits receivable separately from other amounts due by subsidiary companies. Generally

speaking, it is apparent that more information would be welcomed in balance sheets rather than that there should be any discontinuance of the differentiation at present required.

(b) *Profit and Loss Accounts or Statements of Earnings.*

From the information contained in the national papers, it would appear that at present published profit and loss accounts of holding companies are not required to show the actual earnings of subsidiary companies, but there is general agreement that this information should be supplied to shareholders.

The writer of the American paper favours a "two-part" income account, the first dealing with the complete income of the subsidiary companies, showing the allocations made to minority shareholders and the holding company. The second part would show any direct income of the holding company and also the amount transferred from the subsidiary companies' portion. He further recommends that, in order to be even more informative, the subsidiary companies' income statements should be in columnar form differentiating between varying types of companies, e.g., manufacturing and selling, and that there should be a separate column for undertakings not wholly owned by the holding company. He, however, considers that only companies which have transactions with one another should be consolidated in this manner.

The writer of the English national paper is personally of the opinion that full disclosure should be made in the profit and loss account of the total earnings of the subsidiary companies, but recognises that many companies prefer not to bring into their own accounts the whole of the profits earned by subsidiary companies but only such proportion as they may decide to distribute by way of dividends. He therefore suggests a statement of earnings comparable to that just mentioned, but with the difference that it should be supplemental to the profit and loss account and solely for the purpose of supplying additional information to shareholders.

(c) *Directors' Reports.*

The writer of the German paper expresses himself as dissatisfied with the manner in which the requirements relevant to *Konzern* connections are dealt with in Germany. He suggests that the intention was for the annual report to be the principal medium of reporting on *Konzerns* and personally is of opinion that the maximum of information should be given. He recommends that reference should be made to everything of importance that occurs between the holding company and its subsidiaries and points out that each subsidiary company which is itself a joint stock company should in its turn make full disclosure. In his opinion the information should set out the means by which the dependent undertakings are controlled and refer to the results of such centralisation, with its effect on the balance sheet of the company.

(d) *Consolidated Statements.*

Most of the national papers set out suggestions regarding consolidated balance sheets or financial statements to be issued as supplemental to the legal balance sheets of the holding companies. The common motive is the desire to make such statements present a comprehensive view of the combine as a whole, in the simplest and most understandable form. It is generally agreed that, if at all possible, all balance sheets to be consolidated should be made up to the same date. It is also considered important that each company within the group should have, as far as possible, a similar system of accountancy, so that the annual accounts may be prepared in a comparable form. Another important point made is that the same basis of valuation should be applied to the stock in each constituent company and that plant and other fixed assets should be carried in the respective balance sheets and depreciated or amortised on a common basis.

When dealing with the preparation of a consolidated statement it is of the utmost importance to decide what test is to be applied in determining which subsidiary companies are to be consolidated and which are to be shown as investments. It is of interest to note that both the American and German papers suggest that only those companies between which there exists a trading or economic relationship should be consolidated, and

that interests in other subsidiary companies should be regarded as in the nature of financial investments. One view is that consolidation should only be effected where the holding company owns directly or indirectly at least 75 per cent. of the ordinary share capital and, in addition, possesses control of management. In any event the basis adopted should be clearly indicated on the face of the consolidated statement and, as previously noted, this is specifically required in the United States of America under the Securities Acts of 1933 and 1934. Varying views are put forward as to the most appropriate form of presentation. One writer suggests a columnar form with one column for the holding company and one or more for the subsidiaries according to the peculiarities encountered, thus rendering possible distinctions between wholly owned subsidiaries and those where minority interests are involved. Another writer is strongly opposed to a complete consolidated balance sheet, mainly because of the danger of misleading creditors by showing a conglomeration of asset figures which are not in fact available to meet the claims of the creditors of any specific company and the practical difficulties of consolidating the figures of companies operating in different countries subject to varying laws and currency regulations. This writer suggests that the most practical course is to furnish, along with the legal balance sheet and the consolidated profit statement, referred to above, a statement showing the consolidated working capital position. This statement should, he states, be framed with the object of showing the liquid position of the combine and information should also be given regarding the long term assets and liabilities. It appears to me, however, that these statements might be open to similar objections to those appertaining to a consolidated balance sheet.

DETAILED POINTS ARISING IN ACCOUNTS.

It is apparent that the problems arising on the construction and preparation of the accounts of holding companies, especially in regard to consolidated statements, are common to all countries from which papers have been submitted. These may be briefly summarised as follows:—

(a) *Currency and Exchange.*

In addition to adopting the well recognised principles of book-keeping for the conversion of foreign currency transactions, stress is laid on the necessity for having regard to difficulties of remittance when considering the conversion of figures relating to profits and floating assets. It is generally agreed that credit should not be taken for any profits which cannot in fact be remitted to the holding company.

(b) *Inter-Company Transactions.*

The authors of all the papers wherein the point is discussed agree that no inflation of profits or asset values should be permitted to arise as a result of sales by one company to another, or by reason of one company rendering services to another within the same group. Opinions differ as to the necessity of adjusting figures where the transactions are *bona fide* and entered into in the ordinary course of business, particularly where one company manufactures plant for other affiliated companies. For my part I am of the opinion that each case should be dealt with on its merits.

(c) *Minority Interests.*

When consolidating the accounts of the various constituent members of a *Konzern* it is common to find that the holding company has a shareholding of less than 100 per cent. in some of the subsidiary companies. This factor has given rise to many discussions as to the correct method to adopt in effecting the consolidation. One point of view commonly expressed was that only that proportion of the subsidiary company's assets and liabilities should be included which is equivalent to the holding company's percentage of the issued share capital. It is now generally considered that this method does not convey a true statement of the position and that it is preferable that the whole of the assets and liabilities of all subsidiary companies to be consolidated should be brought into the balance sheet or statement, and the proportion of the net assets of any company representing the interests of minority or outside shareholders be shown as a liability.

(d) *Valuation of Investments in Subsidiary Companies—Shares Purchased at Above Par Value—Shares Purchased at Below Par Value.*

These three questions may well be considered under one heading, although the first affects the legal balance sheet and the other two the consolidated balance sheet or statement.

As regards the valuation of investments in subsidiary companies, the English Companies Act prescribes that the basis of valuation must be stated on the face of the balance sheet. It is usual and, in my opinion, desirable to maintain these investments in the books at cost and for the purpose of the published balance sheet to deduct from the aggregate book value of such holdings any reserves created against them. As regards such reserves it is generally agreed that provision should be made to cover trading losses sustained by subsidiary companies and, further, that the amounts necessary therefor may properly be charged before arriving at the published profit.

In regard to the treatment in consolidated statements of the excess, or deficiency, as the case may be, of the cost to a holding company of shares in a subsidiary over the book value of the net assets of the latter, I think there will be general agreement with the view that the objective should be that accounting procedure which attains the most understandable form consistent with the underlying facts.

(e) *Reserves of Subsidiary Companies.*

Many interesting points arise in determining how reserves which were in existence in the accounts of subsidiary companies at the date when their shares were acquired by the holding company should be treated in the consolidated statement of the latter. It is necessary in the first instance to distinguish between reserves against definite anticipated contingencies, which should be treated as such for the purpose of consolidation, and reserves which represent appropriated surplus. In considering the latter, which he subdivides into earned surplus and capital surplus, one writer points out that whilst assets are acquired and liabilities assumed, reserves and surpluses are not exactly of the nature of things which ordinarily are acquired. In other words, such reserves and surpluses are of the same genus as the share capital of the subsidiary and with it constitute the net worth or equity of the subsidiary which should in theory be eliminated against the corresponding elimination of the parent's investment in the subsidiary. He emphasises, however, that a hard and fast formula cannot be laid down, and he illustrates by a series of examples the need for dealing with each case in the light of its own particular facts. The purpose of the examination and adjustments thus detailed is to establish beyond doubt the amount of the surplus of the subsidiary at the date of acquisition. I think that it will be agreed, irrespective of whether or not consolidated statements are prepared, that any distributions out of such surplus should not be regarded as available for payment of dividends by the holding company but should in the accounts of the latter either be carried to a capital reserve or written off the investment in the subsidiary concerned.

(f) *Treatment of Subsidiary Companies' Profits.*

Varying views are expressed as to whether a holding company should bring to the credit of its profit and loss account the full profits earned by its subsidiaries or merely such part thereof as has been declared by way of dividend. Whilst statements of opinion or practice may differ, they do in substance tend to indicate a preference for bringing in only declared dividends, providing the shareholders are also informed as to the total earnings of the group. If this latter information is not given, dividends may be taken credit for in excess of the total earnings for the year without the shareholders being aware of the fact. Two writers emphasise the importance of setting out separately on the balance sheet of the holding company any undistributed profits that have been brought in, and it is manifestly undesirable that such should be distributed to the shareholders of the holding company until actually declared. English Company Law requires the directors of holding companies to report to the shareholders as to whether they have made provision for any losses sustained by subsidiary companies, and as a result it is the practice in England for full provision to be made in the accounts of holding companies for trading losses sustained by subsidiary companies.

METHODS OF COMPUTING COST AND CONTROL OF PRICES BY PUBLIC AUTHORITIES*

by

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THE PRINCIPAL TYPES OF PRICE-REGULATING LEGISLATION AND
ADMINISTRATIVE MACHINERY CLASSIFIED ACCORDING TO PARTICULAR
INDUSTRIAL GROUPS.

A. PUBLIC UTILITIES.

The United States. Public utility rates in the United States are regulated by Federal and State commissions. The criterion of jurisdiction is, theoretically, the geographical scope of the industry. Interstate activity is under Federal control. Interstate commerce is supervised by State and local agencies. The principal rate-regulating bodies are: (a) The (Federal) Interstate Commerce Commission (railroads and rail services, motor buses and trucks, pipe lines, etc.); (b) Federal Power Commission (interstate power); (c) Federal Communications Commission (interstate and foreign wire and wireless communication); (d) State Public Service Commissions (gas, electricity, street, railway, water, heat, telephone, warehousing, etc.); (e) State Insurance Commissioners.

The underlying theory of rate regulation by these bodies is that the utility company is entitled to a fair rate of return on the value of its properties after deducting operating expenses and provision for depreciation.

Great Britain. Various governmental agencies supervise and adjust public utility rates in Great Britain. Parliament and the Board of Trade dominate the rate-regulating policy. Gas and electric rates (of private companies) are determined by two different systems. (a) The sliding-scale and maximum price system provides that the dividends received vary inversely with the rates charged, while maximum prices are related to maximum dividends. (b) The newer "Consumers' Benefit" system operates on much the same plan. Inducement is offered to management to lower its prices by establishing a basic standard rate for the product and granting bonuses in the form of increased dividends to companies undercutting the basis price.

Main line railroad rates are based on a 1913 norm. The Railway Rates Tribunal is authorised to adjust annually the rates charged, raising or lowering them according to the year's earnings to bring them into line with the 1913 standard.

The Railway Rates Tribunal is empowered to review the fares charged by the London Passenger Transport Board. The latter Board has almost a monopoly of London transportation services. In 1933 Parliament passed an Act designed to maintain the efficiency of the Board by requiring it to pay 5 per cent. on the common stock until July, 1935, and 5½ per cent. thereafter with the express provision that if the dividend rate is not met for any three consecutive years after June, 1936, the shareholders may apply for a receivership.

B. MANUFACTURING, MINING, AND TRADE.

The United States. The oldest expedient for maintaining domestic prices of commodities produced in the United States is the protective tariff.

Antitrust and fair trade laws administered by the courts, the Federal Trade Commission, and various State and local authorities attempt to promote equity in business relations. The method proposed by the trust laws is to prevent the formation of large industrial combinations capable of attaining monopoly or near-monopoly positions.

*A General Paper

The theory and reasoning underlying antitrust legislation differs markedly from that which has led to the creation of cartels and trusts under government auspices in European countries.

Special legislation has been enacted to stabilise or increase prices of certain mineral products, for example, gold, silver and bituminous coal.

The Netherlands. As a result of world-wide monetary disturbances and increased tariff barriers, Dutch industry found itself in a very precarious position at the end of 1931. Accordingly, the government acted to protect domestic industries by reserving the greater part of the home market for them. Special import duties were levied and an import quota system imposed. Under the import quota system the Ministry of Economic Affairs worked out a table of maximum imports for certain commodities. The prices of the protected commodities are kept under close observation and measures taken to prevent unwarranted increases. Cost studies have been employed in the difficult problem of determining just prices. In the Netherlands proper the authorities have moved to modify prices that were out of line as individual cases have arisen. In the Netherlands East Indies, however, the government directly intervenes and fixes maximum prices for quota-protected articles.

Great Britain. British industry sets its own prices, though in the case of certain products these prices are reached after consultation with governmental representatives or are subsequently subject to governmental review. Domestic producers of specified products are protected by a tariff. Iron and steel prices are regulated by the trade functioning through the central organ of the local trade associations, the British Iron and Steel Federation. These prices are determined in collaboration with the Import Duties Advisory Committee which seeks to establish prices beneficial to British industry as a whole. In the coal industry prices are fixed by the coal owners working with the Committees of Investigation, government appointed consumers' boards.

Norway. Business enterprise in Norway is governed by the Trust Law of 1926, which provides, among other things, that unreasonably high or low prices may not be charged; that free competition may not be restrained unduly; and that certain unfair business practices, such as discrimination, are illegal. The administration of this broad Act is vested in a control commission appointed by the King which functions through a permanent control bureau. The control organisation is given wide investigative and supervisory powers, particularly over cartels and trade associations, and is authorised to fix maximum profits and maximum and minimum prices.

Germany. Germany inaugurated her programme of governmental price regulation during the World War and has conducted it on a more extensive scale than any of the six nations under discussion. When the Four Year Plan was inaugurated in October, 1936, existing price supervisory machinery was consolidated in the hands of a Price Commissioner with broad administrative and judicial powers. Shortly afterwards a law was passed forbidding price increases without government approval. Other legislation provided rules for particular industries. The result has been that all commodity prices in Germany are subject to government regulation through local price-making and price-supervising authorities co-ordinated by the Price Commissioner.

The precise methods of price determination vary with the industry considered. In general, maximum prices are determined on a cost basis. Price cutting and subcost sales were made illegal by the Competition Act of December, 1934.

C. AGRICULTURE.

The United States.—The Agricultural Adjustment Act of 1938 gives the Secretary of Agriculture authority to limit the growing acreage, stipulate marketing quotas and guarantee returns for producers of wheat, corn, rice, cotton and tobacco who are willing to sign allotment agreements with the Government. The stated purpose of the Act is to raise the purchasing power of the five crops to the 1909-1914 level. Individual states have crop-restricting laws of their own to regulate local conditions.

A number of states fix minimum prices for fluid milk through local milk boards.

The Netherlands.—The Dutch Government endeavours to guarantee minimum returns to agricultural producers of all the principal crops. Governmental agencies, after collaboration with farmers' organisations, determine a "guiding price", on a cost basis for each product. Measures are then taken to make up to the farmer the difference between the world market price and the domestic guiding price.

Great Britain.—Under the Agricultural Marketing Acts of 1931 and 1933 agricultural producers were encouraged to form Boards for each commodity to draw up schemes for marketing farm produce in order to stabilise farm incomes. After the acceptance of a marketing scheme by the producers and Parliament, its price schedules and regulations became legally binding and the Board of Trade was empowered to further the aims of the Scheme by controlling imports of the commodity in question. Schemes were devised to regulate the distribution of hops, pigs and bacon, milk and potatoes.

Special legislation provided for direct subsidy payments to producers of wheat, livestock, milk and sugar upon compliance with specified quantity or cost regulations.

Norway.—Agricultural prices in Norway are regulated for the most part by the farmers themselves through growers' associations acting in co-operation with the Government. The Government supervises agriculture and directly intervenes to regulate prices when it deems it necessary, as in the case of equalising milk prices in various parts of the country. Flour prices are fixed by the state monopoly to include a premium for aiding the grain producers.

The price control board does not interfere with prices approved by the agricultural authorities for the benefit of the farmer.

Hungary.—The Hungarian Government seeks to maintain the price level of certain leading agricultural commodities (e.g., paprika) by providing for the purchase of the entire domestic output by a Government-regulated co-operative organisation. This co-operative sells the product locally at a premium which is used to pay export bounties. Thus the effects of overproduction are minimised.

GOVERNMENT PRICE REGULATION CLASSIFIED ACCORDING TO IMMEDIATE BENEFICIARIES.

Presumably, Government price regulation is intended to promote the "general welfare" of the nation. Just what the "general welfare" is and how it is to be benefited is obviously not easy to determine. I certainly do not intend to indulge in philosophical speculation on such matters as "the greatest good for the greatest number," but it should be pointed out in passing that there is grave danger lest governments confuse the "general welfare" with the *special* welfare of the most politically articulate of the population.

A. CONSUMER BENEFITS.

The United States. The control of public utilities by state public service commissions and the Federal Communications Commission is undertaken largely in the interest of the consumer. The monopolistic nature of the public utility business is such that a preponderance of bargaining strength is thought to rest with the utility company.

Government competition with private industry, e.g., in the production and distribution of electricity in regions where private companies have already been established, is allegedly in the consumers' interest. What is gained by the consumer in the local competitive area, however, is very apt to be paid for by the taxpayers in a larger area, who must contribute taxes to support the government-operated power system.

Great Britain. Gas and electricity rate schemes restrict the charges which private companies can make and thus benefit the consumer.

The Committees of Investigation are charged with looking after the consumers' interest in the determination of coal prices by coal owners.

Norway. The Norwegian industrial price control policy is an attempt to prevent overcharging and excessive profit.

Germany. German control of industrial prices with restriction of profits seeks to safeguard the consumer from excessive prices and sudden or acute price increases.

Hungary. Milk-price regulation is intended to guarantee a low price for that product in the city of Budapest.

B. PRODUCER BENEFITS.

The United States. The protective tariff, the gold and silver purchases, the Agricultural Adjustment Act, the State milk control laws, and the modification of the fair trade laws to admit of retail price maintenance and forbid subcost sales are producer-favouring measures. The relief to the bituminous coal industry also falls in this category.

The Netherlands. The Dutch laws reserving the home market to the domestic agricultural and industrial producer have the benefit of the producer as their stated object.

Great Britain. The protective tariff and the series of agricultural marketing "Schemes" are producer-benefit measures.

Norway. Norwegian agricultural regulation is undertaken by the government particularly in the interest of the farmer.

Germany. The competition and anti-price-cutting laws are to protect business from ruinous competition.

Hungary. The intended beneficiaries of Hungarian paprika marketing legislation are the farmers.

C. BENEFITS TO CONSUMER AND PRODUCER.

The United States. The Interstate Commerce Commission and the enforcement agencies of the anti-trust and fair trade laws seek to maintain a balance between consumer and producer interests.

Great Britain. Railroad unification and rate control on a 1913 base is an attempt to prevent excessively high rates on one hand and unduly low returns on the other.

Norway. The cartel regulation and fair trade aspects of the Norwegian law may be classed as consumer and producer safeguards.

COST BASIS OF GOVERNMENT PRICE REGULATION.

The United States.—Rates based on accurately determined costs of production are the professed aim of Federal and State public utility commissions. The doctrine of a fair return on the value of the properties after deducting operating expenses and provision for depreciation is fundamental to American public utility regulation theory. The problems of what constitutes a "fair return" and a readily acceptable evaluation of properties have continued to vex the interested parties ever since the enunciation of the principle. The efforts of the Tariff Commission to equalise domestic and foreign production costs show another aspect of the recognition by the Government of the significance of cost determination.

Minimum prices fixed by the Bituminous Coal Commission for the different grades and sizes of coal are based on a complex calculation of weighted averages of production costs of mines in the several production zones. State and local fluid milk prices set by milk boards are determined with reference to local costs of production.

The states which have passed laws forbidding sub-cost sales have incurred their own peculiar cost problems.

The Netherlands.—Price control in The Netherlands for agricultural and industrial products is on a cost basis.

In the case of agriculture, the policy of the Government has been to determine the "essential cost of production" for specific products and thereby to calculate a "guiding price" which the Government undertakes to guarantee to the producer. Dutch agriculture has been at a disadvantage in competition with other countries with depreciated currencies, etc., so the difference between the competitive world market price and the domestic guiding price has had to be met by various means.

Certain industrial products are protected from foreign competition in The Netherlands and the Dutch East Indies by a system of import quotas. In the East Indies the protection is carried further and includes maximum price-fixing. In the administration of both of these relief measures, cost determination is necessary. It is assumed that relief is temporary. Between the granting of a return which will barely cover variable costs and a return which will cover depreciation, interest and even a margin of profit lie many gradations.

The criterion of what costs of production are to be included in the prices permitted by the authorities is the proposed duration of the relief.

Great Britain.—Production costs are a factor in the fixing of gas rates though it is not clear what part they play in the establishment of the "basis price" for that commodity, or what relation they bear to competition and public opinion in the price to the ultimate consumer.

The sale of electric power by generating concerns to distributors in the London area is on a cost basis. The basic dividend granted the producers is 7 per cent. on the ordinary capital.

While the prices of coal are largely fixed by the producers, a check is put upon excessive charges by the Government Committees of Investigation. These bodies rely on production costs as a yardstick in determining whether consumers' complaints of specific prices are justified or not.

As in the case of Dutch agriculture, British aid to livestock breeders, wheat and sugar producers takes the form of measures to equalise the domestic costs of production and the foreign costs.

The Government sanctioned hops scheme provides for the sale of hops to brewers at a price intended to represent cost of production plus a fair profit.

Norway.—Price control by the Norwegian authorities differs from that of the other countries in its flexibility. The Commission is empowered to take appropriate measures to maintain fair prices. The criterion of "fairness" is not defined by the law. The courts have declared that a fair price is the market price in a state of free competition. This leaves the price control authorities with vast discretionary powers. We are told that the Board may require extensive accounting data from private concerns. We also learn that excessive profits are considered evidence of excessive charges. Apparently, then, cost of production as a basis for price regulation is implicit in the Norwegian system.

Germany.—The fundamental policy of industrial price regulation in Germany, as already stated, is to protect the ultimate consumer from excessive prices and abrupt price increases. To carry out this policy a system of strict price control largely on a cost basis has been developed. The details vary between industries, but in general an initial base price is calculated from production cost data obtained for a given base period. The period varies with the commodity.

Price increases are permitted by the authorities in response to increases in the cost of production of the given article. In this connection, if the cost increase is occasioned by a rise in the prices of the necessary raw materials, the producer may increase his price by the amount of the raw material price increase. He may not, however, increase his price still further by applying his original percentage mark-up to the higher purchase price of raw materials. Advantage gained from lowered unit costs through increased utilised capacity must be shared with the consumer.

Just which costs are recognised as necessary costs of production to be covered by the price granted varies with the industry. The general policy is to keep these items to a strict minimum.

The monumental task of disseminating cost accounting information and providing uniform systems of accounts within specific industries is undertaken in certain lines of business by trade associations or cost cartels.

The degree to which the permitted price follows the cost price varies between industries. In the shoe manufacture, for example, every "line" must bear its proper share of the cost of production.

Hungary.—It is not clear to what extent production costs are used to determine the price at which milk is bought from dairymen. However, processing and distributing costs are carefully considered in fixing the price paid by the ultimate consumer of milk in Budapest.

OTHER AUDITING AND ADVISORY WORK*

by

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INTRODUCTION.

A considerable amount of advisory work arises from the more well defined branches of professional practice. The character of such problems, however, is by no means limited and many problems presented to the accountancy profession cover a much wider area. This position has arisen from the evolution of modern accountancy as practised professionally. In my view advisory work represents a development of a high order and is very important to us as well as to our clients. Advisory work, therefore, has received considerable attention in the profession in recent years in Great Britain.

Certain definite sub-divisions have been suggested by the Committee and I have endeavoured to keep within these sub-divisions as far as possible.

After dealing at length with the functions of the accountant as executor and trustee ; liquidator of a company ; holder of a receivership for debenture holders and of other receiverships ; trustee in bankruptcy ; and trustee under a deed of arrangement, the writer proceeds to discuss the accountant's advisory functions :—

ADVISORY ASSISTANCE TO BUSINESS MEN IN COMMERCIAL MATTERS AND QUESTIONS OF ORGANISATION

To-day the professional accountant is consulted by business men much more extensively than was the case a decade or so ago. In commercial and industrial affairs, the accountant's activities are expressed in a wide range of appointments and responsibilities and include directorships of companies, and appointments as financial adviser and as an investigator of various types of business, whether manufacturing or distributing.

The Practising Accountant as Director and Financial Adviser to Companies. A public company, about to make an issue of its capital, frequently includes in its board of directors a professional accountant, and companies which are old established and have hitherto recruited directors from the commercial world now turn to the accountancy profession to fill vacant directorships. A commercial mind and a practical outlook are essential qualifications for the accountant who becomes the director of a commercial company. A number of practising accountants have developed these qualities in a marked degree. To a considerable extent the day has gone when a director was invited to join the board of an important company because of his social qualifications. In these days of intense competition it is most important that a director should have definite knowledge of some part of the business which is being carried on. The accountant has that knowledge in regard to accountancy matters, which is so essential to a well-conducted business, and if in addition he has a certain commercial sense it is claimed that his appointment as a director strengthens the board and gives confidence to the shareholders. It is not necessary for the accountant to be a whole time director of the company, although there are certain outstanding cases in Great Britain where the managing director is wholly employed in the service of the company, although he started his career as a professional accountant. Generally speaking, the invitation to become a director is ascribed to one of two causes. The first is that the company has got into financial difficulties and the accountant is invited to join the board with the object of assisting the company to rehabilitate its

* A National Paper.

position and perhaps also to impress the shareholders. In these cases, it need scarcely be said that it is absolutely essential for the accountant to make a complete investigation of the position in order to see whether it is possible to resuscitate the company and to put the business on a sound footing, because, if not, it is far better for him to leave the business alone.

Relations between Directors and Co-operation of Staff. The report of the accountant must be accepted wholeheartedly by his future fellow-directors, because the success of a business depends entirely upon harmonious working. Thus, in framing his suggestions, the accountant should have regard to this important factor, and in the course of his report should point out any apparent lack of loyalty on the part of the chief members of the staff, with whom he will have come into contact in the course of his investigations.

The accountant is usually an ordinary director, but in addition he is sometimes given an office under the title of financial adviser; for this he receives a special annual fee, as his work is more extensive and onerous than that of an ordinary director. He will be specially consulted in regard to financial matters and will be expected to give general advice on finance to the managing director and to the board, at their regular meetings, when occasion arises.

Considerations Arising in Case of Reconstruction. Contemplated alterations in the company's capital, methods of accountancy, banking arrangements and similar matters will receive his special consideration.

In the alteration of the company's capital, it is his duty to consider the structure of the capital, and whether a reconstruction is necessary. If so, he will frame, for the consideration of his fellow directors, the method of writing down the capital and the corresponding assets. For this purpose, it is generally necessary to have valuations made of the fixed assets, such as the land and buildings, plant and machinery, and of the liquid assets, such as stock, book debts and the like, which will require very careful scrutiny. When the real value of the assets has been ascertained, he will consider what amount of capital must be written off to provide for the writing down of the assets. In doing so he will pay particular regard to the rights as between the various classes of shareholders, preference and ordinary. Having considered his scheme and laid it before his fellow directors, he may probably consult the largest shareholders to see whether the proposals are acceptable to them, and for this purpose he will invite them to meet him. This is essential in order to ensure that the scheme will be acceptable to the majority of the largest shareholders.

ISSUE OF PROSPECTUS.

Attention has been drawn to the cases where a director is invited to join the board of a company which finds itself in financial difficulties, but there are other and different circumstances in which a professional accountant may be invited to become a director. The company may be successful and old established, or established for a number of years, and it is considered desirable to strengthen the board by the addition of an accountant. In cases like these it is essential that the past history should be fully known to the intending director. For this purpose, he should be afforded an opportunity of examining not only the published accounts of the company, but also the detailed accounts leading up to the published accounts, which will give him much more information than is afforded by those which are published.

If on the inception of a company he is invited to join the board, he is generally named as a director by the signatories to the Memorandum of Association, or he may be appointed by the Articles themselves. In the latter case he must file with the Registrar of Joint Stock Companies a consent in writing to act as a director. Almost without exception, the director of a public company is bound to be a shareholder, and must hold a certain number of shares as prescribed in the Articles themselves. For these shares he has to pay cash and they must be held in his own right and not as a nominee of any other person. The

minimum qualification is generally fixed at a low figure and in some cases perhaps it would be better if a director's qualification were more substantial than it is.

In the case of a new company which is issuing a prospectus to the public, inviting the subscription of share capital, a director has to satisfy the Registrar of Companies that he has taken, or will take and pay for, his qualification shares. The directors, as officers of the company, are fully responsible for the prospectus, but they will have been advised by solicitors who in turn have been advised by a barrister, expert in company law and in the drafting of prospectuses. Nevertheless, the directors for their own satisfaction should read the prospectus individually and assure themselves that it means what it says and that the average investor is not in any way misled by any of the statements in the prospectus. The average investor, if he intends to apply for shares in a public company which is issuing new capital, studies the prospectus and relies to a considerable extent upon the honesty and integrity of the board of directors.

RESPONSIBILITIES OF DIRECTORS.

The organisation of a joint stock company, through its board of directors, must be very carefully planned to ensure the success of the company, and especially because the directors are responsible to the shareholders for the care and use of their property, which has been placed in the hands of the board for the purpose of earning profits. The board as a whole is, in fact, the accounting party to shareholders, and it is the directors who can be made fully responsible for their acts. Even if some of the directors are whole-time officials of the company and wholly employed in its business, the board has to delegate to certain officials—whether these officials be fellow directors or employees of the company—the duties and responsibilities which devolve upon them.

PERIODICAL STATEMENTS.

The accountant or the secretary-accountant must present to the board regularly returns which will enable the directors to know how the business is progressing, instead of the previous practice, which was dropped many years ago, of waiting for the annual accounts to see the result of the actual trading during the year. If there is a professional accountant on the board, it is generally considered advisable to call him into consultation with the managing director and the secretary, so that they may determine the form of accounts or statements which will be regularly presented to the board. These statements should not be too voluminous, but concise and clearly understandable by the members of the board. With the knowledge of statistics which professional accountants now have to acquire for the purpose of their examinations, it is possible to present statements to directors in the form of graphs which show trading results and other information pictorially. Even if these are not produced for each member of the board, it is most useful for the managing director to have them in his own office.

RELATION OF COST ACCOUNTS TO FINANCIAL ACCOUNTS AND PERIODICAL RETURNS.

In a manufacturing business, it is usually possible to estimate with reasonable accuracy the value of the stock on hand, provided cost accounts have been kept. A study of these accounts shows the percentage of gross profit which is being earned. If this percentage, after making an allowance for loss and wastage, be deducted from the figure for sales since the date of the previous return, the cost price of the goods sold is ascertained. Taking the aggregate of the stock as shown on the previous account, and of purchases since the relevant date, and deducting the cost price of goods sold, the difference represents the estimated value of the stock on hand at the end of the period. Having ascertained by this means the value of stock in hand, it should be possible, within a few days after the close of each month, to show in balance sheet form the floating assets, consisting of estimated stock in hand (calculated as indicated above), book debts and cash; and after deducting from this total the current liabilities, the balance shows the working capital in the business. Similarly the statement should comprise figures for the fixed assets, consisting of land and

buildings, plant and machinery, fixtures and fittings, motor cars and the like, and on the other side of the balance sheet will appear fixed capital, including reserves. Only a general outline of the form of the statement has been given, because the requirements of each business call for variations to enable the statement to be presented in the most suitable form.

Sales are reported to the board and the figure for sales up to the end of the previous week can generally be given. It is always advisable to give comparative figures for the corresponding period in the previous year and if there have been any variations, due to seasonal changes, such as Easter occurring early in the previous year and later in the year under review, notes should be made to this effect. Purchases should also be reported from the buying department, because in connection with finance it is necessary to be certain that funds are available to meet the payments for these purchases at their due dates.

Capital expenditure, before being incurred, must always be reported to the board, and should be considered in relation to the monthly financial statements referred to above ; this is most important because, unless there is a surplus of fixed capital, it follows that any extra capital expenditure must be provided out of the ordinary working capital, which will reduce the resources of the business, and this is sometimes dangerous. A successful business when opportunity arises usually re-invests, by the purchase of new plant and machinery, the amount of depreciation which is provided in the annual accounts, thus bringing plant and machinery up to date to enable the company to compete successfully in the markets.

At fixed periods, profit and loss accounts, whether actual or estimated, should be presented to the board for their consideration. In certain cases these accounts can be presented weekly, but generally speaking, they are presented at fixed monthly periods. In the profit and loss account, whether estimated or otherwise, comparative figures for the same period in the previous year should be given. Without periodical profit and loss accounts it is impossible for directors to know whether the managing director is carrying out the policy which has been decided upon by the board, and whether he is an efficient managing director ; he can only be judged by the results which he produces, and although, in many cases, there are reasons for results not coming up to expectations, it is for the managing director to report matters of this kind to his board before they are disclosed by the figures prepared by the secretary-accountant.

A very important matter in regard to a manufacturing business is the introduction of proper cost accounts if they are not in existence already. If cost accounts are in existence they should be examined by the accountant director from the point of view of principle and of their day-to-day operation. If not, it will be his duty to consider with the managing director the best system which can be introduced according to the necessities of the business.

EXPERT OPINION IN LEGAL PROCEEDINGS.

THE PROFESSIONAL ACCOUNTANT AS AN EXPERT WITNESS.

The professional accountant is often retained to give evidence in litigation concerning matters in which accounts are involved. In certain previous well known cases he has been called upon to give his opinion as to whether another professional accountant had done all that was reasonably necessary in the auditing of accounts before appending his certificate.

When the evidence relates purely to a question of fact the accountant usually finds no difficulty in giving his evidence, because facts are not a matter of opinion. Where, however, as more often happens, the accountant is called upon to express an opinion as to what, in his view, should have been done in certain circumstances, then, unfortunately, one often finds an expert accountant on the one side, giving his opinion on behalf of the plaintiff, and another expert accountant on the other side giving an exactly contrary

opinion on behalf of the defendant. Such cases are regrettable, but none the less it is difficult to see how it could be otherwise, because when it is a question of what should be included in the balance sheet or profit and loss account before the certificate of the auditor is appended, accountants must have varying views. Generally speaking, it is only by a careful study of the law, as laid down by the Courts in decided cases of this kind, that a considered opinion can be formed.

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In the Law Courts the Judges listen very carefully to the professional accountant in cases where his evidence relates purely to questions of fact, because there can rarely be two opinions as to entries in books and records; but a Judge must find it a little difficult in giving his decision in cases where he has before him the evidence of eminent accountants on both sides, holding different opinions.

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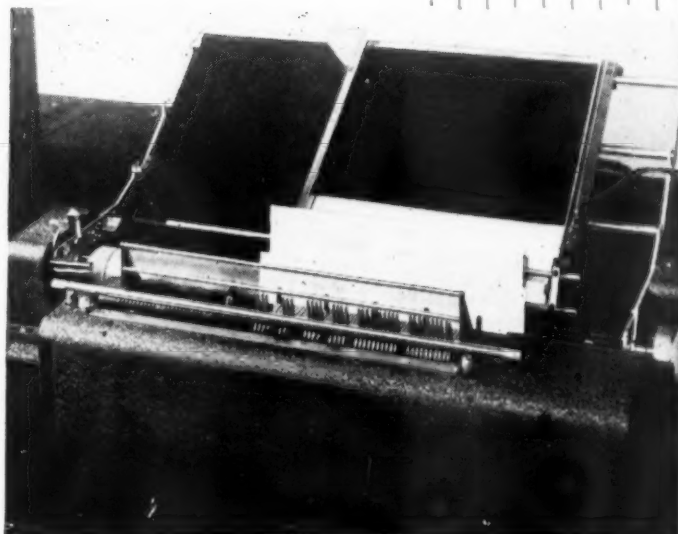
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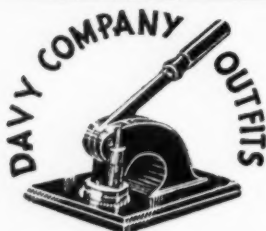
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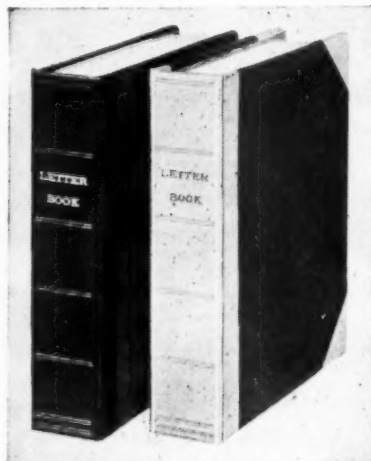
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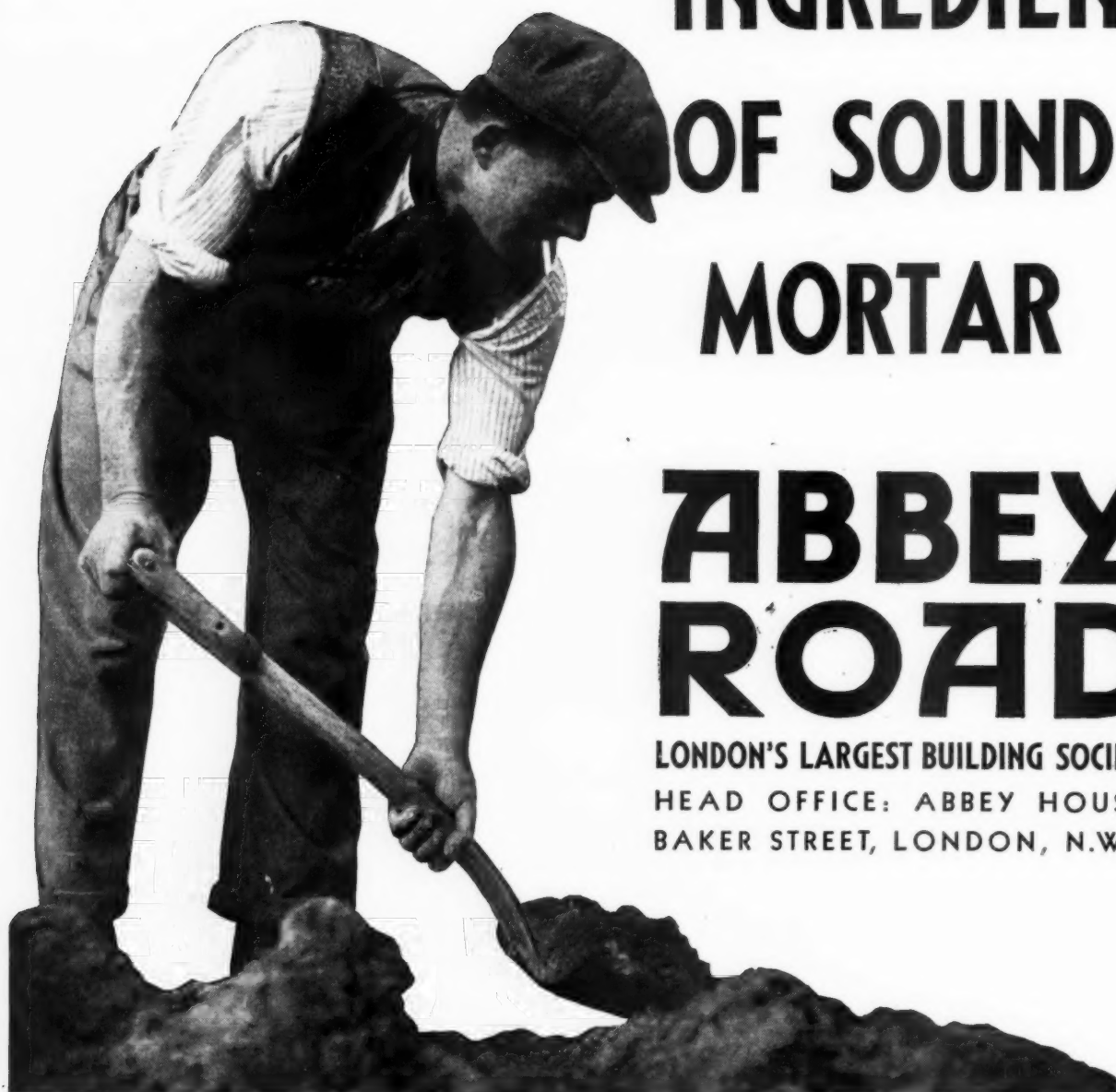
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